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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45
(Report to Congress)

COMMENTS OF BELL ATLANTIC

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I. Introduction and Summary.

The Commission can report to Congress that its Universal Service orders to date are consistent with the letter and spirit of the 1996 Act, provided that it modifies or clarifies the current structure in two respects.² First, it should permit carriers to continue to use federal high-cost funds to support local rates, rather than using all of the disbursements to support reductions in charges for interstate access services, which the Commission has not defined as universal services. By using federal funding to provide direct support for local rates, the Commission's appropriate decision to provide 25% of a state's universal service need through federal funding will not cause upward pressure on

¹ The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

² The Commission sought comments on its forthcoming report to Congress in its January 5, 1998 Public Notice, DA 98-2 ("Public Notice"). The report must be submitted by April 10, 1998.

local rates in high-cost states. Second, the Commission should acknowledge that it has not limited the states' ability to determine the service areas for telecommunications carriers that are eligible for universal service support. By clarifying that its suggestions to the states in this regard are not binding, the Commission will have complied with the statutory division of authority.

High-cost universal service funding has thus far been at levels that have allowed local rates to remain affordable and subscribership high. By making explicit the existing implicit federal high-cost support mechanisms (weighting of dial equipment minutes, high-cost loop assistance, and Long Term Support), without increasing federal funding levels, and requiring that all interstate service providers contribute to the funding of these mechanisms, the Commission has fulfilled Congressional intent in enacting Section 254.

The revenue base upon which high-cost universal service contributions are based also strikes the jurisdictional balance that Congress carefully structured. By assessing such contributions on interstate retail revenues, the Commission has preserved for the states the option of tapping the intrastate revenue base to supplement the high-cost federal program to rebalance rates within their purview.

II. With Some Modifications, The High-Cost Fund Structure Is Consistent with the 1996 Act and With Sound Public Policy.

In its report to Congress, the Commission is required to justify its decisions regarding the percentage of federal universal service support and the revenue base from which such support is derived as consistent with the 1996 Act. Public Notice

at 2, item 5. The Commission can accurately report that its Universal Service Orders will meet the statutory requirements of ensuring that local rates remain affordable if it uses federal funding first to support local rates in rural, insular, and high-cost areas, rather than assigning it all to reduce interstate access charges. Moreover, if it retains funding at current levels, the Commission will avoid serious distortions caused by sharp local rate increases in low-cost states.

A. The Act Requires a Federal/State Universal Service Partnership.

The 1996 Act codifies Congressional intent that the universal service program is to be a cooperative federal/state program designed to maintain affordable local rates. Federal funding for rural, insular and high-cost areas is designed to provide a nation-wide mechanism to support universal service, while states remain responsible, as they were before enactment, for adopting any additional mechanisms they find necessary to support universal service within each state. This divided responsibility can continue to be accommodated without significantly impacting local rates.

Section 254(a) requires the Commission, upon recommendation of a federal-state joint board, to define services “that are supported by Federal universal support mechanisms and a specific timetable for implementation.” 47 U.S.C. § 254(a)(1) (emphasis added). All of the services that the Commission has defined under this provision are local telephone services. *See Report and Order*, 12 FCC Rcd 8776, ¶¶ 61-84 (1997).

In the following subsection Congress makes clear its intention that “[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.” 47 U.S.C. § 254(b)(5) (emphasis added). The next three

subsections define the services eligible for federal support, establish a federal contribution mechanism, and specify who is eligible to receive universal service support. 47 U.S.C. § 254(c)-(e). Subsection (e) cross-references Section 214(e), which authorizes the states to designate eligible telecommunications carriers (i.e., those that may receive support under Section 254(e)) and to define the service areas within which they must offer the services which the Commission has designated pursuant to Section 254(c) as those that may receive universal service support. *See* 47 U.S.C. § 214(e).

The states' parallel role in funding universal service is specified in Section 254(f). Under that subsection, a state may adopt regulations that are "not inconsistent with the Commission's rules ... to preserve and advance universal service within that state." 47 U.S.C. § 254(f) (emphasis added). As the legislative history shows, Congress intended that "State authority with respect to universal service is specifically preserved under new section 254(f)." H.R. Conf. Rep. 104-458 at 132.

Accordingly, the Act preserves the existing universal service partnership, under which a federal fund provides support from interstate revenues to maintain and support the designated universal services, while the states may use revenues from intrastate services to continue to provide further support to such services as needed. States may establish their own universal service funds for this purpose or use other mechanisms to support local rates in high-cost areas. Whatever specific mechanism an individual state adopts, it will involve use of revenues from intrastate services, over which the states have exclusive jurisdiction, to support the intrastate costs of providing universal service.

B. Rates Will Remain Affordable If the Federal Fund Is Not Increased.

In its May 8, 1997 Universal Service Order, the Commission properly found that local rates nationwide are generally affordable, with subscribership levels at about 94%. Report and Order at ¶ 112.³ One of the major reasons that universal service has been attained is the existing federal high-cost support program that has successfully allowed local exchange carriers with particularly high costs to keep local rates down to levels that nearly all consumers can afford.⁴ By preserving existing levels of federal support of local rates in high-cost states, the Commission can fulfill its Congressional mandate to maintain universal service in rural, insular, and high-cost areas without disrupting service elsewhere by increasing local rates in some states to pay for unnecessary higher support in other states.

To help achieve this goal, the Commission required interstate high-cost contributions to be based upon the interstate retail revenues of all common carriers, Report and Order at ¶¶ 831-36, and other service providers that offer interstate telecommunications services. *Id.* at ¶¶ 794-800. This mechanism serves several public policy objectives. First, it insures that all providers of interstate services contribute to the specific federal universal support mechanisms, as Congress required. 47 U.S.C. § 254(d), (e). Second, it assesses an explicit contribution liability on revenues in place of the

³ Nationwide subscribership levels have remained constant, at about 94%, since 1992. *See* Telephone Subscribership in the United States, Industry Analysis Division, Common Carrier Bureau, at 15-18 (rel. Jan. 1998).

⁴ Lifeline and Link-up programs, which the Commission expanded by requiring inclusion of all states and by increasing federal funding amounts, help preserve universal service for low-income individuals. Report and Order at ¶¶ 326-409.

implicit subsidy mechanisms that were previously incorporated in interstate rates, again as Congress directed. 47 U.S.C. § 254(e). Third, it preserves for the states the revenue base that Congress anticipated they could use, as needed, to assess contributions from providers of intrastate services to an intrastate high-cost fund. 47 U.S.C. § 254(f).

By assigning federal high-cost funds exclusively to reduce interstate access charges rather than to support local rates, however, the existing universal service program will not fulfill Congress's mandate to keep rates for local services at affordable levels in high-cost areas. Interstate access charge reductions might reduce interstate toll rates, yet toll rate reductions appear nowhere in Section 254 as a universal service objective. Nor is toll service listed among the services which the Commission has designated, pursuant to Section 254(c), as those "that are supported by the Federal universal service support mechanisms." 47 U.S.C. § 254(c)(1).

Moreover, if the existing federal support for local rates is reduced, consumers in high-cost areas may be deprived of access to affordable universal service. If they cannot afford to subscribe to local telephone service, they will be unable to place toll calls, regardless of their price, and the goal of universal service will be lost. In addition, customers in high-cost areas who make few, if any, interstate toll calls, or subscribe to toll blocking services that prevent them from placing such calls, will not see their telephone bills decline if all federal universal service support goes to reduce access charges. And, in any event, there is no guarantee that interexchange carriers would even

pass along the access charge reductions by lowering their toll rates -- because historically they have not.⁵

The federal fund should instead be used initially to support local rates at current levels, before any remaining funds are allowed to flow to access charge reductions. Providing local rate support from the federal fund would be consistent with Congress's goals of ensuring that universal service rates for consumers in rural, insular, and high-cost areas are just, reasonable, and affordable and are reasonably comparable to those charged in urban areas, 47 U.S.C. § 254(b)(1) and (3), and would eliminate any need to increase the size of the federal fund above existing levels in order to maintain affordable local rates. If all states were guaranteed that the amount of high-cost support to any state would not fall below the current amount, adjusted for inflation, no recipient state could suffer a significant rate increase, thereby allaying the fears of some state commissions that their ratepayers will be harmed.⁶ A program which holds states harmless at current federal funding levels would moot their call for 100% federal funding of universal service.

⁵ *See* PAUL W. MACAVOY, THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE SERVICES 77-78 (1996) (“[L]ong-distance carriers ...did not pass on all of the access cost reductions to consumers.”). More recently, AT&T’s November 1, 1997 long distance rate changes increased by three hours the period in which the higher “day” rate is in effect during weekdays. The resulting increase in the price paid for calls placed during these additional hours could more than offset the reduction in the per-minute rate that took effect at the same time.

⁶ *See, e.g.*, Comments by the New Mexico Attorney General, the Nebraska Public Service Commission, the Texas Public Utility Commission, and the Kansas Corporation Commission (all filed Jan. 20, 1998)

An increase in federal funding to 100% of the total universal service “need” would be unnecessary and inconsistent with the federal-state partnership envisioned in the Act. The Commission properly recognized that a portion of the cost of the loop and other non-traffic sensitive costs are assigned to the federal jurisdiction through the separations process. Report and Order at ¶ 270. It then used an overall 25% factor as a surrogate for the portion of those costs that should be recovered from the federal fund, “because loop costs will be the predominant cost that varies between high cost and non-high cost areas.” *Id.* at ¶ 269. It properly found that the states should retain their historic responsibility for supporting the remaining portion of the universal service need through existing mechanisms. *See id.* at ¶ 271.

The existing federal universal service program has kept local rates affordable, and there is no reason why a new program of the same size will not continue to do so, provided that the current amount of funding allocated to each state is maintained, adjusted for inflation. By holding all states harmless, the Commission will avoid upward rate pressure in recipient states, retain the 25% federal funding level, and maintain the federal/state universal service partnership envisioned by Congress.

By contrast, a program that substantially increases the federal high-cost support fund, whether through an increase in the federal share or in the “costs” that the fund must support, could disrupt carefully-developed intrastate pricing mechanisms within states that today are net contributors to high-cost support. Many of these states have already developed intrastate mechanisms to average local rates within their jurisdiction or to use revenues from other intrastate services to support local rates in high-cost areas. As a result, ratepayers in low-cost areas may already pay higher local rates to

help maintain affordable service in high-cost areas of the state, and increasing their rates still further to send increased support to other states would impose on them a double-whammy, with possible adverse effects on subscribership.

Increasing their rates to reduce charges in other states would be particularly egregious where the rates being supported are already lower than those in the donor states. For example, local rates in major cities in a number of Bell Atlantic states that are net *donors* to the high-cost fund substantially exceed, in some cases by a factor of two, the rates in some of the major cities of states that are net *recipients* of universal service support. As shown in Attachment 1, some of the cities in the donor states with higher rates also have lower per-capita income, higher unemployment, and lower job growth than cities in recipient states whose local rates are already lower. Yet advocates of a large federal high-cost fund want to add to this disparity by forcing net donor states to increase their payments into the fund. There is no statutory or public interest justification for such a result.

All universal service funding provided by carriers must ultimately be recouped from customers as a cost of doing business. If spread evenly among all customers, each billion dollar increase in the universal service fund would add fifty cents to the cost of every local telephone line each month. An increase in the high-cost fund from the current approximate \$1.5 billion level to \$10.5 billion, as would be the case under some of the proxy model proposals now before the Commission,⁷ would cost each end user an average of \$4.50 each month, or \$54.00 each year. Significantly increasing

⁷ The cost proxy models currently before the Commission could produce total high-cost funding requirements of up to \$14 billion.

high-cost contributions in some states in order to send money to other states could raise local rates in the donor states by amounts that could adversely impact subscribership levels, in contravention of the Congressional mandate that local rates should remain affordable. 47 U.S.C. § 254(b)(1) ("Quality services should be available at just, reasonable, and affordable rates.").

The effect of these massive rate increases would not be limited to net "donor" states. Increases of this magnitude would be reflected in local bills throughout the country and could cause increases in the nationwide average telephone bill. And with subscribership rates already high, it is unlikely that additional subsidies will have much effect on subscribership levels in high-cost areas.⁸

C. Cost Proxy Models Should Not Be Used.

The Commission plans to develop a cost proxy model that would identify high-cost areas at the wire center, or smaller, level. The costs developed in this model would be compared with benchmark rates to determine those areas that should receive high-cost support. However, even though each of the proposed models has been revised a number of times, none comes close to calculating with any accuracy the cost of providing local service in all localities.⁹ Each release has within it some extreme aberrations and cannot reasonably form the basis for the universal service program.

⁸ The increased Lifeline support that the Commission adopted could help increase subscribership among low-income consumers.

⁹ In some cases, insufficient data have been made available on the models to allow Bell Atlantic to determine the extent of the inaccuracies. This raises serious questions as to whether adoption of any such model, without a full opportunity for parties to analyze its full impact, would meet Administrative Procedure Act requirements.

For example, the models generally do a poor job of calculating the number of access lines in each area. As a result, the costs per line predicted by the models bear little relationship to the actual costs of providing service. This raises questions about whether the models accurately predict the amount and type of facilities needed to provide universal service. In addition, the models contain wide disparities in the amounts of universal service support that they calculate will be needed in each area, raising questions about whether any model can be made sufficiently reliable to be used as a basis of calculating high-cost support.

The fundamental problem is that the models are all based upon theoretical networks with theoretical costs, rather than the actual forward-looking costs of providing universal service. While proponents of the various models claim that they estimate the forward-looking costs of serving customers, the models take into account only a few of the factors that determine the design and construction of a local telephone network, such as population density, soil type, and slope. They do not consider such additional factors as natural barriers, zoning restrictions, availability of rights of way, and aesthetic considerations, all of which influence the selection of routes and types of facilities that will be deployed. In addition, the models assume that a LEC will always have installed the optimum-size central office switch for the actual volume of traffic that it encounters at any time. In fact, in the real world, it makes no economic sense for carriers to scrap and write off all of their switches every time increases in traffic volumes fill them to capacity. Instead, they find it far more cost-effective to add capacity to existing switches to meet the increased demand. As a result, these models inherently misrepresent the costs that both incumbent carriers and new entrants incur to serve high-cost areas.

Universal service support in high-cost areas has long been based upon actual, measured costs of providing service and has resulted in affordable rates nationwide. Nothing in the Act requires the Commission to change completely its basis for providing such support, nor is any public policy served by doing so.

It is time for the Commission to tell Congress that use of a cost proxy model is not the best approach. Instead, the Commission should continue to support universal service in high-cost states at present levels (adjusted for inflation) using its new explicit funding mechanism. Such a mechanism fulfills Congressional intent that universal service should continue to be supported even as increased competition is introduced into the local and long distance markets.

III. Interstate Common Carriers and Other Interstate Telecommunications Providers Should Contribute to Universal Service.

Consistent with the requirements of Section 254(d) of the Act, the Commission required all common carriers that provide interstate telecommunications services to contribute to universal service. Report and Order at ¶¶ 794-800. The only exception permitted under the Act is those carriers whose contribution would be *de minimis*. *Id.* at ¶¶ 802-03, ***Fourth Order on Reconsideration***, FCC 97-420 at ¶ 297 (rel. Dec. 30, 1997) (“Reconsideration Order”).¹⁰ It properly denied the claims of a multitude of entities that sought exemptions from their statutory obligations, finding that the language of Section 254(d) that all interstate telecommunications carriers “shall

¹⁰ The Commission asked whether it met statutory requirements in this area in the Public Notice at 2, item 3.

contribute” is mandatory, not permissive. *Id.* at ¶¶ 276-84. The Commission also acted within the discretion that Congress gave it by requiring non-carrier providers of telecommunications to others for a fee to contribute to the fund based upon their interstate end user revenues. Report and Order at ¶ 795. Such entities compete with common carriers, and exempting such companies could skew the market by making non-carrier telecommunications artificially less expensive than telecommunications services offered by common carriers.

IV. The Commission Properly Found That Only Eligible Telecommunications Carriers, As Designated by the States, May Receive High-Cost Support But Should Confirm That Only States May Specify Their Service Areas.

The Commission has properly acknowledged that Section 254(e) limits rural, insular, and high-cost support to eligible telecommunications carriers that are designed by the states pursuant to Section 214(e)(2). Report and Order at ¶¶ 130-32.¹¹ Under the Act, states may classify as eligible only those carriers that offer all universal services, and advertise the availability of such services, within service areas that the states specify. 47 U.S.C. § 214(e)(1), (2). In its May 8 Order, however, the Commission suggested (1) that service areas should be smaller than the study areas of large incumbent LECs, (2) that incumbent LECs’ service areas should include geographical areas that they have not traditionally served, and (3) that support should be calculated over areas no larger than those served by a single wire center. Report and Order at ¶¶ 185, 193. Any

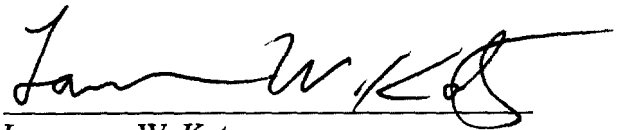
¹¹ States were originally required to submit eligible carrier designations by December 31, 1997, but the Commission allowed states that were unable to meet that deadline to petition for retroactive support. Reconsideration Order at ¶ 23.

Commission intention that these suggestions are binding on the states in determining service areas within which carriers may receive universal service support would, of course, be contrary to Section 214(e), which makes such decisions wholly the province of the states. Accordingly, so long as the Commission confirms that the language in its order relating to the size of eligible carriers' service areas is simply a non-binding recommendation and not a mandate to the states, its orders in this regard are in compliance with the Act. *See* Report and Order at ¶¶ 184-85.

V. Conclusion.

Accordingly, with the modifications and clarifications discussed above, the Commission can report to Congress that its universal service program for rural, insular, and high-cost areas is consistent with the 1996 Act.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Lawrence W. Katz", written over a horizontal line.

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Table 1

A Sample of Net Contributor States in the Bell Atlantic Region

(Table 1 shows states with relatively high local rates, low income per capita, high unemployment rates, and low job growth rates and yet will be net contributors towards the federal high-cost assistance)

City	State	Company	1995 Local Rate	1995 Income per Capita	1995 Income spent on Local Telephone	1995 Unemployment Rate	Job Growth CAGR 91-96 USA Gr rate 1.98%
Buffalo	NY	Bell Atlantic	\$30.88	\$22,645	1.6%	5.4%	0.09%
Springfield	MA	Bell Atlantic	\$22.01	\$22,342	1.2%	5.8%	1.50%
Providence	RI	Bell Atlantic	\$23.47	\$23,730	1.2%	7.0%	0.97%
Philadelphia	PA	Bell Atlantic	\$18.87	\$26,959	0.8%	5.9%	0.88%
Richmond	VA	Bell Atlantic	\$23.96	\$25,851	1.1%	3.7%	2.04%
Baltimore	MD	Bell Atlantic	\$24.88	\$25,347	1.2%	5.6%	0.99%
Washington	DC	Bell Atlantic	\$19.50	\$30,824	0.8%	4.2%	2.06%

Table 2

A Sample of Net Recipient States

(Table 2 shows states with relatively low local rates, high income per capita, low unemployment rates, and high job growth rates and yet will be net recipients from the federal high-cost assistance)

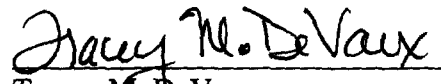
City	State	Company	1995 Local Rate	1995 Income per Capita	1995 Income Spent on Local Tel.	1995 Unemployment Rate	Job Growth CAGR 91-96 USA Gr rate 1.98%
Dallas	TX	SBC	\$17.66	\$26,803	0.8%	4.7%	2.82%
Houston	TX	SBC	\$18.15	\$25,449	0.9%	5.7%	2.82%
St. Louis	MO	SBC	\$18.18	\$25,170	0.9%	4.8%	2.12%
Nashville	TN	Bell South	\$17.72	\$25,077	0.8%	3.4%	3.03%
Raleigh	NC	Bell South	\$17.21	\$24,675	0.8%	2.6%	2.96%
Beaufort	SC	United	\$19.76	\$23,774	1.0%	3.0%	2.68%
Memphis	TN	Bell South	\$18.66	\$23,640	0.9%	4.9%	3.03%
Fort Dodge	IA	Contel	\$14.03	\$21,152	0.8%	4.2%	2.20%
Corvallis	OR	U.S. West	\$18.84	\$21,257	1.1%	2.2%	3.46%
Butte	MT	U.S. West	\$18.22	\$19,011	1.2%	5.8%	3.38%
Rapid City	SD	U.S. West	\$22.95	\$20,176	1.4%	3.0%	3.31%
Minneapolis	MN	U.S. West	\$20.39	\$27,436	1.1%	3.8%	2.62%

Source and Notes:

- (1) Local Rate includes unlimited local calling, touch-tone, SLCs, surcharges, and taxes.
- (2) Local Rate from: The Industry Analysis Division's Reference Book of Rates, Price Indices and Household Expenditures for Telephone Service; March 1997; and Local Exchange Tariffs.
- (3) Income per capita from: (a) Bureau of Economic Analysis for Income and (b) Bureau of the Census for Population.
- (4) Unemployment Rate and Job Growth Rate from: Bureau of Labor Statistics.

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of January, 1998 a copy of "Comments of Bell Atlantic" was served on the parties on the attached list.


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